IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRENTWOOD INVESTORS, a California general partnership; and BRENTWOOD HOLDING COMPANY, a California general partnership,	)	
Plaintiff,	)	
	)	C-95-0856 (EHC)
v.	)	
WAL-MART STORES, INC., a Delaware corporation,	)	ORDER
Defendant.	)	

This case involves a 1985 sale-leaseback transaction ("Transaction") of multiple store sites between Defendant Wal-Mart Stores, Inc., a Delaware corporation with its principal place of business in Arkansas, and Plaintiffs Brentwood Investors and Brentwood Holding Company, both California general partnerships having their principal places of business in San Francisco, California. Wal-Mart Properties, Inc., was also involved in the Transaction although it is not named a party.

Plaintiffs were granted leave to file a second amended complaint. A motion for leave to file a third amended complaint was denied. Pending are Defendant's motion for summary judgment and Plaintiffs' motion for leave to file a fourth amended complaint which was filed while its motion for leave to file a

third amended complaint was pending.

I. Background

On August 14, 1985, Brentwood Holding Company, Wal-Mart Properties, and Wal-Mart Stores executed an "Agreement of Purchase and Sale" (hereafter "Purchase Agreement"). (Ex. C to Comstock Declaration in Support of Motion for Summary Judgment, hereafter "Comstock Declaration"). Pursuant to the Purchase Agreement, Wal-Mart Properties agreed to sell thirteen parcels of land on which it had or intended to build a Wal-Mart store to Brentwood Holding Company.[1] The stated purpose of the Purchase Agreement was to "provide for the purchase and sale of each Property by [Wal-Mart Properties] to [Brentwood Holding Company], and thereafter for the lease of each Property by [Brentwood Holding Company] to [Wal-Mart Stores, Inc.]." Id.

The Purchase Agreement provided for separate closing dates for each of the properties. Ex. C at ¶ 3.03 to Comstock Declaration. The Purchase Agreement further provided that Wal-Mart Stores, Inc., would execute and deliver a lease to Brentwood Holding Company in a form attached to the Purchase

[1] Under the Purchase Agreement Wal-Mart Properties had the right to substitute another property for any of the parcels listed prior to October 31, 1986 or otherwise due to Buyer's objection to the condition of title of any listed property.

Agreement twenty days before the closing on a property. Ex. C at ¶ 4.04 to Comstock Declaration. The properties to be purchased were identified in Exhibit A to the Purchase Agreement. Wal-Mart Properties retained the right of substitution of properties prior to October 31, 1986 or at any time thereafter if Brentwood Holding Company objected to the condition of title of a property. Exhibit A to the Agreement also set forth the purchase price for each property. The Purchase Agreement contemplated closing on each of the properties no later than January 31, 1987.

The Purchase Agreement set forth conditions precedent to closing on each of the properties. These conditions were designated covenants, unless otherwise expressly provided, for the benefit of Brentwood Holding Company which could be waived by Brentwood Holding Company. Ex. C at ¶ 4.01 to Comstock Declaration.

Paragraph 4.04 provided:

> On or prior to each closing, Tenant [Wal-Mart Stores] shall furnish Buyer with a Lease executed by Tenant naming Buyer as landlord and Tenant as tenant (the "Lease"), and Buyer shall execute the Lease and deliver three (3) duplicate originals to Title Agent twenty (20) days prior to closing and Title Agent shall return two duplicate originals to Tenant. The Lease shall be in the form attached hereto as Exhibit B with the blanks therein filled in as is appropriate

for each individual Property. **The minimum rent shall be 10.15% of the purchase price of the Property. The percentage rent shall be 1% over the fourth full fiscal year base. The purchase price in Section 11(b) shall be the same as the cost which Buyer incurred for the Property.**

Ex. C to Comstock Declaration (emphasis added).[2]

Paragraph 6.07 provided:

> This Agreement contains the entire agreement of the parties hereto concerning the subject matter hereof, and supersedes any prior written or oral agreements between them concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, **oral or written**, relating to the subject matter, which are not fully expressed herein.

Ex. C to Comstock Declaration(emphasis added).

Paragraph 6.04 provided that:

> This Agreement shall be governed by Arkansas law, except to the extent the law of the state where each Property is located must govern.

Ex. C to Comstock Declaration.

Plaintiffs allege that Brentwood Holding Company signed the Purchase Agreement before Wal-Mart Properties had identified the particular store sites to be purchased. Plaintiffs further allege that they were not involved in the selection,

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[2] There is no "Section 11(b)." Apparently this provision refers to ¶ 2.02 regarding price and payment for the properties.

development, or management of the store sites. Plaintiffs do not allege when they first learned the sites selected by Wal-Mart Properties. There is no dispute that Plaintiffs were provided with a form of the proposed lease before signing the Purchase Agreement. However, Plaintiffs aver that they were not represented by counsel when the Purchase Agreement was executed and that they only retained counsel prior to the closings on the properties. Declaration of John Benetti in Opposition to Defendant's Motion for Summary Judgment, hereafter “Benetti Declaration” and the Declaration of David G. Finkelstein, Esq., hereafter “Finkelstein Declaration.”

Plaintiffs also allege that Wal-Mart made representations regarding the income stream they would earn from investing in the transaction and that Wal-Mart actively solicited investment by them based on two “material financial” representations: (1) that Plaintiffs would receive 10.15% return on investment (without an escalation provision) and (2) Plaintiffs would be protected against inflation by the percentage rent clauses in each of the leases which were to become effective in the fifth year of the leases. Plaintiffs do not allege that these representations were included in the Purchase Agreement or subsequent agreements.

Plaintiff Brentwood Investors, a California general partnership of which Brentwood Holding is the managing general partner, subsequently executed leases, in the form attached to the Purchase Agreement of four properties for a term of twenty-five years each. Ex. D to Comstock Declaration. Those properties are located in Daphne (or Lake Forest), Alabama; El Paso, Texas; Hattiesburg, Mississippi; and Ft. Dodge, Iowa.

A. Relevant Lease Terms Applicable to All Four Stores

Each of the leases required the annual payment of fixed minimum rent of 10.15% of the purchase price of the properties. In addition, the leases required the annual payment of percentage rent equal to one percent of gross sales beginning in the fifth year of the lease (provided that the gross sales in the fifth year exceeded the fourth year's gross sales). Ex. D at 4(b) to Comstock Declaration. The leases further provided that:

> Except as otherwise expressly provided herein, this Lease shall not terminate; nor shall Tenant have any right to terminate this Lease or be entitled to the abatement of any rent or any reduction thereof, nor shall the obligations hereunder of Tenant be otherwise affected, by reason of any damage to or destruction of all or any part of the demised premises from whatever cause, the taking of the demised premises from whatever cause, the taking of the demised premises or any portion thereof by condemnation of otherwise, the prohibition, limitation

> or restriction of Tenant's use of the demised premises, or interference with such use by any private person or corporation, or by reason of any eviction by paramount title or otherwise, or Tenant's acquisition of ownership of the demised premises otherwise than pursuant to an express provision of this Lease, or for any other cause whether similar or dissimilar to the foregoing, any present or future law to the contrary notwithstanding, **it being the intention of the parties hereto that the fixed minimum rent, percentage rent, and all other rents and charges payable hereunder to or on behalf of Landlord, shall continue to be payable in all events and the obligations of Tenant hereunder shall continue unaffected, unless the requirement to pay or perform the same shall be terminated pursuant to an express provision of this Lease.**
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> * * * * * *
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> **Tenant waives all rights now or hereafter conferred by law** (i) to quit, terminate or surrender this Lease or the demised premises or any part thereof, or (ii) **to any abatement, suspension, deferment or reduction of the fixed minimum rent, percentage rent or any other sums payable hereunder** to or on behalf of Landlord, regardless of whether such rights shall arise from any present or future constitution, statute or rule of law.

Ex. D to Comstock Declaration (emphasis added). Furthermore, Wal-Mart Stores as Tenant retained exclusive control of the premises with the right to assign or sublet the premises. Ex. D at ¶ 14 to Comstock Declaration. With respect to subletting, the leases provided that:

> In the event that Tenant sublets the entire demised premises and receives from such subtenant a total rent in excess of that payable by Tenant to Landlord pursuant to Section 4 hereof, Tenant shall pay to Landlord annually at the times specified in section

> 4(b) hereof one-half (1/2) of the excess, if any, between the rent paid to Tenant by such subtenant and the rent payable by Tenant to Landlord pursuant to Section 4 hereof with respect to the immediately preceding fiscal year of Tenant.

Ex. D at ¶ 14 to Comstock Declaration.

Paragraph 18 stated the remedies for default by the Tenant, including:

> . . . Landlord may, so long as such default continues, either (i) terminate this Lease by written notice to Tenant, which written notice shall specify a date for such termination at least fifteen (15) days after the date of such notice or (ii) not terminate this Lease and exercise any of its rights under Section 18(d).
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> * * * * *
>
> (d) In the event Landlord does not terminate this Lease as a result of the default of Tenant, Tenant shall remain and continue liable to Landlord under all of the terms of this Lease; Landlord may evict Tenant and let or relet the demised premises or any or all parts thereof for the whole or any part of the remainder of the term hereof, or for a period of time in excess of the remainder of the term hereof. . .
>
> (e) The remedies of Landlord in the event of the default of Tenant as provided in this Section 18 are intended to be exclusive and not subject to the provisions of Section 25 hereof.

Ex. D at ¶ 18 to Comstock Declaration. Section 25 provides that:

> Unless expressly provided otherwise herein, remedies conferred by this Lease upon the respective parties are not intended to be exclusive, but are cumulative and in addition to remedies otherwise

afforded by law.

Id.

None of the leases contained a provision requiring Wal-Mart Stores to continue to operate Wal-Mart stores at these locations for the term, or any portion thereof, of the leases.

B. Additional Relevant Lease Terms Applicable to the Hattiesburg Store

On November 12, 1990, Wal-Mart and Brentwood Investors executed an "Amendment to Lease Agreement" for the Hattiesburg store (hereafter "First Amendment to Hattiesburg Lease" or "First Amendment"). Under the First Amendment, Brentwood Investors agreed to "purchase" an $853,000 expansion of the Hattiesburg store from Wal-Mart "at a return based on a 10.15 constant"; deletion of the "Fixed Minimum Rent" provision of that lease; and insertion of a new "Rent" provision which provided that Wal-Mart agreed to pay:

> a percentage rent equal to one percent (1%) of that amount by which the gross sales, as hereinafter defined, in any fiscal year commencing with the 1992 fiscal year exceed the gross sales during the 1991 fiscal year of the term of the lease. For the 1992, 1993 and 1994 fiscal years, gross sales shall be reduced .25% prior to the calculation of percentage rent, thereafter, Landlord shall receive all of the percentage rent due under the terms of this Lease. . . . **Further, nothing in this Paragraph or any other provision of this Lease Agreement shall be construed as an implied covenant on the part of Tenant to**

> **continuously operate its business in the Demised Premises during the term of the Lease or to continue paying Percentage Rent after such time as Tenant may choose to cease operating its business in the Demised Premises.**

Ex. F at ¶ 3 to Comstock Declaration (emphasis added).[3]

In addition, the following paragraph was inserted regarding use of the premises:

> **It is expressly agreed that nothing contained in this Lease Agreement shall be construed to contain a covenant, either express or implied, to either commence operation of a business or thereafter continuously operate a business in the Demised Premises. Landlord recognizes and agrees that Tenant may, at Tenant's sole discretion, and at any time during the term of this Lease, cease the operation of its business in the Demised Premises; and Landlord hereby waives any legal action for damages or for equitable relief which might be available to Landlord because of such cessation of business activity by Tenant;** provided, however, nothing in this paragraph shall relieve Tenant from paying the rent and other payments due under this Sub-Lease or otherwise discharge Tenant from any of its other obligations provided herein.

Ex. D at ¶ 4 to Comstock Declaration (emphasis added).

On May 15, 1992, Brentwood Investors and Wal-Mart executed a second "Amendment to Lease Agreement" in connection with the Hattiesburg store. Ex. G to Comstock Declaration. In this Amendment (hereafter "Second Amendment of Hattiesburg Lease" or

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[3] This paragraph was deleted by a second amendment of the Hattiesburg lease described below.

"Second Amendment"), the parties deleted paragraph 3 of the First Amendment (quoted above) and inserted the following:

> Effective the Reimbursement Date,[4] Paragraph 4(b) of the Lease, which is entitled "Percentage Rent", shall be deleted and the following paragraph inserted in its stead.
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> > (b) Percentage Rent: In addition to the Rent hereinabove provided, Tenant shall pay to Landlord on or before the sixtieth (60th) day after the expiration of each of Tenant's fiscal years (as such fiscal years may be established by Tenant) of the term hereof, a percentage rent equal to one percent (1%) of that amount by which the gross sales, as hereinafter defined, in any fiscal year commencing with the 1992 fiscal year exceed the gross sales during the 1991 fiscal year of the term of the lease. For the 1992, 1993 and 1994 fiscal years, Landlord shall receive 75% of said percentage rent and Tenant will retain 25%, thereafter, Landlord shall receive all of the percentage rent due under the terms of this Lease. . . . **Further, nothing in this Paragraph or any other provision of this Lease Agreement shall be construed as an implied convenant [sic] on the part of Tenant to continuously operate its business in the Demised Premises during the term of the Lease or to continue paying Percentage Rent after such time as Tenant may choose to cease operating its business in the Demised Premises.**

Ex. G to Comstock Declaration (emphasis added).

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[4] The First Amendment defines the "Reimbursement Date" as the date of receipt of funds for the $853,000 expansion. (Ex. F to Comstock Declaration).

Plaintiffs allege that Brentwood Investors agreed to the clauses regarding operation of the stores based on Wal-Mart's oral representations that it was unlikely to close the Hattiesburg store if Brentwood purchased the expansion and that if it did so, it would not open another store nearby. Plaintiffs allege that Wal-Mart implied as much in its letters of February 9 and December 7, 1989. Ex. E to Second Amended Complaint.[5]

C. Closure/Relocation of the Four Stores

In 1994, Wal-Mart closed its operations at the Hattiesburg store and opened another store nearby. Plaintiffs allege that Wal-Mart is not obligated to pay percentage rent at the new location.

In 1994, Wal-Mart also informed Brentwood that it was in the process of closing and sub-letting the Alabama, Texas, and Iowa stores and that it intended to discontinue paying percentage rent after those stores were closed. Wal-Mart has

[5] In the letter of February 9, 1989, Wal-Mart proposed that the lease would be amended for a "fresh 25 year term" and that "Percentage rent would be adjusted to 1% over the 4th year base of the new 25 year term with $1.00 per square foot cap." It thus appears that Wal-Mart intended to push back the date for payment of percentage rents by providing for a fresh (new) 25 year term.

constructed new stores in Lake Forest, Alabama, and El Paso, Texas, in close geographic proximity to Plaintiffs' sites. Brentwood alleges on information and belief that Wal-Mart is obtaining another property in close geographic proximity to its Fort Dodge, Iowa site.

Wal-Mart continues to pay the fixed minimum rent, but contends that it is not obligated to pay percentage rent under the terms of the leases. Wal-Mart has sublet one of the stores; the others apparently remain closed and vacant.

Plaintiffs allege that Wal-Mart Stores breached or anticipatorily breached the El Paso, Lake Forest, and Ft. Dodge leases to avoid paying percentage rent for those locations. Plaintiffs allege that the implied covenant of good faith and fair dealing "obligates Defendant to continue to lease the premises and pay percentage rent unless it closes its store and does not open a new store nearby, and to pay to Plaintiffs a percentage of rent."

Plaintiffs allege that Wal-Mart Stores violated an implied term and condition of the Hattiesburg lease, as amended, by vacating that store and opening a new store nearby. Plaintiffs contend that Wal-Mart Stores should be estopped from relying on language in the Amendments permitting it to cease operations at

that store.

Plaintiffs also allege that Wal-Mart Stores fraudulently induced Brentwood Investors to “purchase” the Hattiesburg expansion and amend the Hattiesburg lease by representing that it was unlikely to close that store if Plaintiffs did so. Plaintiffs also allege that Defendant falsely or with reckless disregard has represented that if it did close that store, it would not open a new store nearby. Plaintiffs seek a declaratory judgment that Wal-Mart Stores is obligated to pay percentage rent for the four locations.

Wal-Mart has filed a motion for summary judgment on each of Plaintiffs' claims. (Dkt.46). Plaintiffs oppose the motion supported by several affidavits. (Dkt. 57). Wal-Mart has filed a "Motion to Strike Plaintiff's Opposition to Wal-Mart's Motion for Summary Judgment" and a "Motion to Strike Affidavits Submitted in Support of Plaintiff's Opposition.” In the alternative, Wal-Mart asks to conduct additional discovery and an extension of time to file its reply. (Dkt. 76). Wal-Mart has since filed its reply to Plaintiffs' response to the motion for summary judgment. (Dkt. 82).

Wal-Mart's motions to strike will be denied. Furthermore, its motion for additional discovery and an extension of time to

file its reply will be denied; its reply will be deemed timely filed.

The Court now turns to Wal-Mart's motion for summary judgment.

II. Standard on a Motion for Summary Judgment

Summary judgment is appropriate when the movant shows "there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. Pro. 56(c). "One of the principal purposes of the summary judgment rules is to isolate and dispose of factually unsupported claims." Celotex Corporation v. Catrett, 477 U.S. 317, 323-24 (1986). Substantive law determines which facts are material. "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." Anderson v. Liberty Lobby, 477 U.S. 242, 249 (1986).

The dispute must also be genuine. A dispute about a material fact is genuine if "the evidence is such that a reasonable jury could return a verdict for the non-moving party." Id. at 249. There is no issue for trial unless there is sufficient evidence favoring the non-moving party. If the evidence is merely colorable or is not significantly probative,

summary judgment may be granted. Id. at 249-50. In a civil case, the question is:

> whether a fair-minded jury could return a verdict for the plaintiff on the evidence presented. The mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff.

Id. at 252.

The moving party who has the burden of proof on the issue at trial must establish all of the essential elements of the claim or defense for the court to find that the moving party is entitled to judgment as a matter of law. Fontenot v. Upjohn, 780 F.2d 1190, 1194 (5th Cir. 1986); Calderone v. United States, 799 F.2d 254, 259 (6th Cir. 1986). However, the moving party need not disprove matters on which the opponent has the burden of proof at trial. Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986). Thus, summary judgment is proper if the non-moving party fails to make a showing sufficient to establish the existence of an essential element of their case on which they will bear the burden of proof at trial. Id. See also, High Tech Gays v. Defense Indus. Sec. Clearance Office, 895 F.2d 563 (9th Cir. 1990).

III. Discussion

A. Choice of Law

The first issue to be resolved is what law governs Plaintiffs' claims. Wal-Mart contends that the states with the most "consistent and significant nexus" to the issues are the states where the properties are located. Plaintiffs contend that Arkansas law applies based upon the choice of law provision in the Purchase Agreement. Both parties alternatively cite to California law.[6]

A district court exercising diversity jurisdiction applies the choice of law rules of the forum state in deciding conflicts of law, in this case, California. Cleary v. News Corp., 30 F.3d 1255, 1265 (9th Cir. 1994); Waggoner v. Snow, Becker, Kroll,

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[6] Plaintiffs contend that a factual dispute exists regarding the applicable choice of law sufficient to preclude summary judgment. Plaintiffs rely on Mencor Enterprises, Inc. v. Hets Equities Corp., 190 Cal. App.3d 432, 436, 235 Cal. Rptr. 464 (1987). In Mencor, the court found that a promissory note executed by a California resident which designated Colorado law as controlling did not as a matter of law validate the contract, specifically the interest rate, in light of California's fundamental policy with respect to usurious transactions. Whether the parties' choice of law governed in a California forum depended upon the reasonable relationship of the contract to Colorado, the substantial contacts of the parties with Colorado, and consideration of California's fundamental policy regarding usury, all of which presented issues of fact. Mencor does not stand for the proposition that choice of law issues necessarily preclude summary judgment as Plaintiffs argue. In any event, Plaintiffs have not demonstrated a divergence in the substantive law among or between the states involved.

Klaris & Krauss, 991 F.2d 1501, 1506 (9th Cir. 1993). Under California law, if a contract contains a choice of law provision, that provision controls. Nedlloyd Lines, B.V. v. Superior Court, 3 Cal. 4th 459, 11 Cal. Rptr. 2d 330, 834 P.2d 1148 (1992). Even tort law claims related to a contract are subject to the choice of law provision in the contract. Id. Accordingly, the Court first considers whether the choice of law provision in the Purchase Agreement applies to Plaintiffs' claims.

In the Second Amended Complaint, Plaintiffs allege that Defendant closed or notified Plaintiffs of its intention to cease operating at four of thirteen locations contrary to leases of those locations as well as misrepresented the income that Plaintiffs would earn on their investment in the sale-leaseback transaction. Plaintiffs allege that Defendant misrepresented the return on their investment in the sale leaseback transaction upon which they reasonably relied.

Plaintiffs have not alleged that Defendant breached the Purchase Agreement per se. Furthermore, the leases for the four locations do not incorporate by reference the terms of the Purchase Agreement. The choice of law provision in the Purchase Agreement does not control the choice of law applicable to

Plaintiffs' claims.

Where a contract does not designate the applicable governing law, "California's approach to choice of law questions focuses on the 'governmental interest' of each state involved in the litigation." Waggoner, supra. See Application Group, Inc. v. Hunter Group, Inc., 61 Cal.App.4th 881, 896, 71 Cal. Rptr.2d 73, 82 (Ct. App. 1998); Clothesrigger, Inc. v. GTE Corp., 191 Cal.App.3d 605, 614-15, 236 Cal.Rptr. 605, 609-10 (Ct. App. 1987).

> Under this approach, California law will be applied unless the foreign law conflicts with California law and California and the foreign jurisdiction have significant interests in having their law applied. Where significant interests conflict, the court must assess the 'comparative impairment' of each state's policies. The law applied will be that of the state whose policies would suffer the most were a different state's law applied. A separate choice-of-law inquiry must be made with respect to each issue in a case. The preceding rules apply regardless of whether the dispute arises out of contract or tort.

Application Group, 61 Cal. App.4th at 896 (quoting S.A. Empresa v. Boeing Co., 641 F.2d 746 (9th Cir. 1981))(internal citations omitted); Waggoner, at 1507 ("[t]here is no true conflict unless the laws of the two jurisdictions differ and both states have a legitimate interest in having their law apply;" if there is a conflict between the law of the two jurisdictions, courts must

determine and apply the law of the jurisdiction whose interest would be most impaired if its law were not applied).

The primary dispute in this case is whether a covenant of continuous operation should be implied into each of the leases. Accordingly, the Court must determine whether a true conflict exists between the law of the states in which the individual stores are located and California law. The second issue to be resolved is whether Defendant misrepresented to the Plaintiffs that if they paid for expansion of the Hattiesburg store, Defendant would not close that store and open another store in close proximity. With respect to this claim, the Court must only determine whether a true conflict exists between California and Mississippi law.

1. Implied Covenant of Continuous Operation

A covenant of continuous operation will be implied under California law if a commercial lease does not provide for a fixed rent, but only a minimum rent plus a percentage of sales.[7]

[7] California implies a duty of good faith and fair dealing into every contract, including leases. Sachs v. Exxon Co., U.S.A., 9 Cal. App. 4th 1491, 1498, 12 Cal.Rptr.2d 237, 242 (Ct. App. 1992). The duty of good faith and fair dealing requires that neither party do anything which will have the affect of destroying or injuring the rights of the other party to receive the benefits of a lease. Id.

College Block v. Atlantic Richfield Co., 206 Cal.App.3d 1376, 254 Cal. Rptr. 179 (Ct. App. 1988); Westside Center Assoc. v. Safeway Stores 23, Inc., 42 Cal.App. 4th 507, 49 Cal.Rptr.2d 793 (Ct. App. 1996). Id. "A covenant of continued operation can be implied into commercial leases containing percentage rental provisions in order for the lessor to receive that for which the lessor bargained." Id. A covenant will be found "[t]o effectuate the intent of the parties . . . if after examining the contract as a whole it is so obvious that the parties had no reason to state the covenant, the implication arises from the language of the agreement, and there is a legal necessity." Id.

i. Texas Law

A covenant of continuous use will be implied under Texas law if such obligation was so clearly within the contemplation of the parties that they deemed it unnecessary to expressly include such provision. See Nalle v. Taco Bell Corp., 914 S.W.2d 685, 688 (Tex. Ct. App. 1996)[8]; Marvin Drug Co. v. Couch,

[8] In Nalle, the court declined to imply a covenant of continuous use where the lease provided for the payment of fixed rental, in addition to percentage rent, after extensive negotiations. The court declined to decide whether a covenant of continuous use would be implied if the fixed rental was inadequate, concluding that the fixed rent at issue was substantial and not inadequate. Id.

134 S.W.2d 356, 361 (Tex. Ct. App. 1939). Cf. Lilac Variety, Inc. v. Dallas Texas Co., 383 S.W.2d 193, 194 (Tex.Civ.App. 1964)(satellite tenant had the right to cancel its lease after major tenant discontinued operations where satellite tenant's lease provided that major tenant would remain a tenant during term of satellite tenant's lease). Whether an obligation of continuous use was contemplated by the parties is determined as of the time the parties signed the contract. Id. A covenant of continuous use will also be implied where the rent is based solely on a percentage of sales without payment of fixed adequate minimum rent. Marvin Drug, supra.; Palm v. Mortgage Investment Co., 229 S.W.2d 869, 871 (Tex.Ct.App. 1950)(covenant of continuous use not implied where lease provided for the payment of a substantial fixed minimum rent). However, a covenant of continuous use will not be implied simply to make a contract fair, wise, or just. Nalle, supra. Furthermore, a covenant will not be implied under Texas law as to a matter specifically covered by the written terms of a contract.[9] Exxon

[9] Unlike California and other states, a duty of good faith and fair dealing are not implied into every contract under Texas law unless a special relationship exists between the parties. English v. Fischer, 660 S.W.2d 521 (Tex. 1983); Formosa Plastics Corp. U.S.A. v. Presidio Engineers & Contractors, Inc., 960 S.W.2d 41, 52 (Tex. 1998); Texstar North

Corp. v. Atlantic Richfield Co., 678 S.W.2d 944, 947 (Tex. 1984).

Texas courts have not decided whether a covenant of continuous operation will be implied if sufficient fixed minimum rent is not required to be paid in addition to percentage rent. While Texas may at some point decide this issue contrary to California law, the Court concludes that a true conflict does not presently exist between the law of California and Texas with respect to the implication of covenants to operate.

ii. Alabama Law

A covenant of continuous operation will be implied under Alabama law based upon the presumed intention of the parties as reflected from the terms of the lease. Nelson v. Darling Shop of Birmingham, Inc., 275 Ala. 598, 157 So.2d 23 (1963); Percoff v. Solomon, 259 Ala. 482, 67 So.2d 31 (1953).[10] Thus:

> An implied covenant must rest entirely on the presumed intention of the parties gathered from the terms as actually expressed in the written instrument itself, and it must appear that it was so clearly within the contemplation of the parties that they

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America, Inc. v. Ladd Petroleum Corp., 809 S.W.2d 672 (Tex. Ct. App. 1991).

[10] In Percoff, the court declined to imply a covenant of continued operation, where the percentage lease at issue was in writing, in the absence of mistake or fraud. Id.

> deemed it unnecessary to express it, and therefore omitted to do so; or it must appear that it is necessary to infer such a covenant in order to effectuate the full purpose of the contract as a whole as gathered from the written instrument. It is not enough to say that an implied covenant is necessary in order to make the contract fair, or that without such a covenant it would be improvident or unwise, or that the contract would operate unjustly. It must arise from the presumed intention of the parties as gathered from the instrument as a whole.

Id. Accord Nelson, supra.

The Court finds that a true conflict does not exist between the law of Alabama and the law of California.

iii. Iowa Law

A covenant of continuous use will be implied under Iowa law where a tenant is obligated to pay a significant part of the rent as a percentage of the tenant's gross receipts. East Broadway Corp. v. Taco Bell Corp., 542 N.W.2d 816 (Iowa 1996). See Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp., 266 N.W.2d 22 (Iowa 1978). Cf. Rothe v. Revco D.S., Inc., 976 F. Supp. 784 (Ind. 1997)(under Indiana law, covenant implied-in-law is presumed from the relation of the parties to the agreement and the object to be achieved by such agreement, declining to imply covenant). The intent of the parties is determined from the terms of the lease, what is necessarily implied from the terms, and circumstances surrounding formation and execution of

the lease. East Broadway Corp., supra.

Thus:

> Contractual obligations may arise from implication as well as from the express writing of the parties. "A contract includes not only what is expressly stated but also what is necessarily to be implied from the language used; and terms which may clearly be implied from a consideration of the entire contract are as much a part thereof as though plainly written on its face."
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> * * * * * *
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> Courts are slow to find implied covenants. The obligation must arise from the language used or it must be indispensable to give effect to the intent of the parties; it must have been so clearly within their contemplation that they deemed it unnecessary to express it. It can be justified only on the ground of legal necessity and can arise only when it can be assumed it would have been made part of the agreement if attention had been called to it. Moreover, an implied covenant cannot be found when the contract is fully integrated.

Fashion Fabrics, 266 N.W.2d at 27-28 (quoting Freeport Sulphur Co. v. Am. Sulphur Royalty Co. of Tex., 117 Tex 439, 451, 6 S.W.2d 1039, 1042 (1928)). Nevertheless, when rent is fixed exclusively or primarily on the basis of a percentage rent of the lessee's gross revenues or profit, an obligation on the part of the lessee to continue operating in good faith may be implied. Id. at 28.

The Court finds that a true conflict does not exist between

Iowa and California law.

iv. Mississippi Law

A covenant for continuous use may also be implied under Mississippi law if the lease provides for percentage rent in addition to substantial or adequate fixed minimum rent. See Great Atlantic & Pacific Tea Co. v. Lackey, 397 So.2d 1100, 1102 (Miss. 1981). However, a covenant will not be implied where express clauses of a contract "negate any conclusion that could be drawn that there was an implied covenant of continuous use." Id. See Polk v. Gibson Products Co. of Hattiesburg, Inc., 257 So.2d 225 (Miss. 1972).

The Court concludes that a true conflict does not exist between Mississippi and California law with respect to implication of a covenant of continuous use.

2. Hattiesburg Fraud Claim

The second choice of law issue is whether a true conflict exists between Mississippi and California law with respect to Plaintiffs' fraud claim.

The elements of intentional fraud under California law are: "(1) misrepresentation (false representation, concealment, or nondisclosure); (2) knowledge of falsity (scienter); (3) intent to defraud (i.e., to induce reliance); (4) justifiable reliance;

and (5) resulting damages." Anderson v. Deloitte & Touche, LLP, 56 Cal.App.4th 1468, 1474, 66 Cal.Rptr.2d 512, 515 (Ct.App. 1997) (quoting Molko v. Holy Spirit Assn., 46 Cal.3d 1092, 1108, 252 Cal. Rptr. 122, 762 P.2d 46 (1988), cert. denied, 490 U.S. 1084 (1989)); Lazar v. Superior Court of Las Angeles County, 12 Cal. 4th 631, 638, 49 Cal. Rptr.2d 377, 380-81, 909 P.2d 981 (1996)(same). California also recognizes promissory fraud, whereby a "promise to do something necessarily implies the intention to perform; hence, where a promise is made without such intention, there is an implied misrepresentation of fact that may be actionable fraud." Lazar, supra. However, a promise or representation of future conduct is only actionable as fraud if it was made without the present intent to perform. O'Mary v. Mitsubishi Electronics America, Inc., 59 Cal.App.4th 563, 579, 69 Cal.Rptr.2d 389, 399 (Ct.App. 1998); Magpali v. Farmers Group, Inc., 48 Cal.App.4th 471, 55 Cal.Rptr.2d 225 (Ct.App. 1996). See id.

The elements of actionable fraud under Mississippi law are: (1) a representation; (2) its falsity; (3) its materiality; (4) speaker's knowledge of its falsity or ignorance of its truth; (5) intent that the representation should be acted on in a manner reasonably contemplated; (6) the hearer's ignorance of

its falsity; (7) the hearer's reliance on its truth; (8) the hearer's right to rely thereon; and (9) consequent and proximate injury. Allen v. MAC Tools, Inc., 671 So.2d 636, 642 (Miss. 1996); Johnson v. Brewer, 427 So.2d 118, 121 (Miss. 1983). A promise of future conduct may be found fraudulent under Mississippi law if the hearer proves that the speaker intended, at the time of the statement, to induce reliance by speaking a falsehood. Singing River Mall Co. v. Mark Fields, Inc., 599 So.2d 938, 945 (Miss. 1992).

Mississippi's fraud elements 1-3 are equivalent to element 1 of California law; element 4 is equivalent to element 2; element 5 is equivalent to element 3; elements 6-8 are equivalent to element 4; and element 9 is equivalent to element 5. A true conflict does not exist between California and Mississippi law as to a claim for fraud. Furthermore, the elements to establish promissory fraud under California and Mississippi law are the same.

A “true conflict” does not exist between California and Mississippi law with respect to Plaintiffs' fraud claim. Therefore, California's and Mississippi's respective interests in application of their law need not be addressed. California law applies to Plaintiffs' claims.

B. Do Factual Issues Preclude Summary Judgment on Plaintiffs' Implied Covenant Claim?

Defendant contends that it is entitled to summary judgment on Plaintiffs' covenant claim because the leases did not expressly contain a covenant of continuous operation and the express terms of the leases preclude implication of such a covenant into the leases. Defendant also contends that the leases do not expressly require it to use “best efforts” to maximize sales so as to entitle Plaintiffs to percentage rent.

Defendant has submitted the affidavit of Thomas P. Seay (“Seay Affidavit”), the Executive Vice President of Real Estate and Construction for Defendant at times relevant to Plaintiffs' claims. Seay had primary responsibility for Defendant's leasing and real estate efforts at the relevant time. Seay avers that the four properties were opened and operated as “Wal-Mart Discount Stores” until Defendant stopped operating from those stores and opened much larger “Wal-Mart Supercenters” in close proximity. The Supercenters included grocery stores, remained open 24 hours, and offered miscellaneous services such as fast food and auto and vision centers. Seay opines on the industry practice and customary usage in commercial leasing of shopping centers. Seay avers that Defendant's corporate policy is not to

enter into an operating obligation except in rare instances and for only limited periods of time. Seay avers that the Transaction did not constitute one of those rare instances; nor does he describe what constitutes such an occasion. Seay further avers that if Brentwood Holding Company had insisted during negotiations on an operating obligation, Defendant would not have agreed to the Transaction.

Defendant has also submitted the affidavit of Anthony Fuller ("Fuller Affidavit"), Defendant's staff counsel who "assisted" Defendant with the sale-leaseback arrangement. Fuller avers that he was aware of Defendant's policy "as to operating covenants and industry custom and practice as described in [the Seay Affidavit]." Fuller further avers that he intended the sale-leaseback arrangement to conform to Defendant's policy and industry custom and practice and that he would have so informed Plaintiffs "[h]ad there been any suggestion by them that they wanted or believed they had obtained an operations obligation[.]" Fuller further avers that sometime prior to the closings of the individual locations, but after the Purchase Agreement was signed, "Brentwood's attorney was concerned that the Lease did not impose an operations obligation on Wal-Mart, and expressed a desire to negotiate for

a modification to the lease; I (being aware of Wal-Mart's corporate policy not to agree to operating covenants) refused. [Plaintiffs] and [its] counsel elected to nevertheless go forward with the real estate closings." Finally, Fuller avers on information and belief that Plaintiffs never warranted or represented to any of their lenders, orally or in writing, that the leases contained an operating covenant, which would have significantly benefitted them in trying to finance the program.

As discussed above, a covenant of continuous operation can be implied into a commercial lease containing percentage rental provisions to ensure that a commercial lessor receives that for which the lessor bargained. College Block, 206 Cal.App.3d 1376, 254 Cal. Rptr. 179 (Ct. App. 1988); Westside Center Assoc. v. Safeway Stores 23, Inc., 42 Cal.App. 4th 507, 49 Cal.Rptr.2d 793 (Ct. App. 1996). Id. An operating covenant will be found "[t]o effectuate the intent of the parties . . . if after examining the contract as a whole it is so obvious that the parties had no reason to state the covenant, the implication arises from the language of the agreement, and there is a legal necessity." Id. Thus:

> A percentage lease provides a lessor with a hedge against inflation and automatically adjusts the rents if the location becomes more valuable. It is

> advantageous to the lessee if the "location proves undesirable or his enterprise proves unsuccessful" Thus, both parties share in the inherent risk. Inherent within all percentage leases is the fundamental idea that the business must continually operate if it is to be successful. To make a commercial lease mutually profitable when the rent is a minimum plus a percentage, or is based totally on a percentage, a covenant to operate in good faith will be implied into the contract if the minimum rent is not substantial.

College Block, 206 Cal.App.3d at 1380, 254 Cal.Rptr. at 181.

Nevertheless, in interpreting a contract, the whole contract must be taken together so as to give effect to each clause. Id. Furthermore, contracts are to be interpreted so as to make them reasonable without violating the intent of the parties. Id. A covenant will only be implied to give effect to the parties' intentions if after examining the contract as a whole "it is so obvious that the parties had no reason to state the covenant, the implication arises from the language of the agreement, and there is a legal necessity." Id. The leases at issue do not give rise to such an implication.

First, the leases did not require Defendant to operate its stores (Discount or otherwise) for the term of the leases. Gross sales under the leases expressly included sales of future subtenants in the percentage rent calculations. Furthermore, the "use of premises" clause provided that:

> [Defendant] may use the demised premises for any lawful purpose. Tenant shall conduct its business insofar as the same relates to Tenant's use and occupancy of the demised premises in a lawful manner and in strict compliance with all governmental laws, rules, regulation and orders applicable to the business of Tenant conducted in and upon the demised premise.

In addition, the leases permitted Defendant to assign or sublet the properties to third parties without Plaintiffs' consent and without restriction as to use.

Furthermore, the fixed minimum rent cannot be found to be insubstantial. The purchase price for the four locations totaled $12,170,000 (as reflected by Exhibit A to the Purchase Agreement). Defendant agreed to pay between $284,000 and $353,000 per location per year for the term of the leases as fixed minimum rent or $1,264,789.50 per year. Over twenty-five years, Plaintiffs will receive approximately $31,619,737.50.

An operating covenant was not expressly included in the leases, nor does evidence reflect that the parties contemplated such a covenant. It is undisputed that Defendant would not have entered the Transaction if Plaintiffs had insisted on such a provision. Furthermore, the language of the leases does not give rise to such an implied covenant. The leases expressly contemplated that Defendant would not continue to operate

throughout the term of the leases. Finally, Plaintiffs are receiving substantial fixed rent; therefore, there is no legal necessity shown. For these reasons, Defendant will be granted summary judgment.

C. Do Factual Issues Preclude Summary Judgment on Plaintiffs' Fraud Claim?

With respect to the Hattiesburg location, Brentwood alleges that Wal-Mart "falsely and fraudulently, expressly and impliedly, represented" to Brentwood that if it would pay for expansion of the Hattiesburg store, it "would not open another store nearby and would continue to pay percentage rent." Wal-Mart contends that it is entitled to summary judgment on this claim in the absence of "any substantial evidence" in support of a fraud claim.

Wal-Mart contends that during discovery, Brentwood admitted that this cause of action is premised on statements made by Sandra Watson, Defendant's representative, prior to the First Amendment of the Hattiesburg lease. Watson stated that the additional provision specifically disclaiming an operating covenant was being added at the request of Defendant's counsel and that it would not change the original lease, at least as

Defendant understood the lease. Plaintiffs characterize this statement as a misrepresentation because that they construed the original lease differently than did the Defendant. As discussed above, the lease did not originally contain a covenant to operate and such covenant cannot be implied. After executing the First Amended Lease, Plaintiffs executed a Second Amended Lease. They do not allege, nor is there evidence that the purport of those amendments were misrepresented to them.[11] In light of the explicit provisions of the Second Amendment, Plaintiffs cannot now claim that they were mislead by oral representations made prior to executing the First Amendment. There is no credible evidence that Defendant intentionally mislead Plaintiffs. Defendant will be granted summary judgment on this claim.

III. Motion for Leave to File Fourth Amended Complaint

Plaintiffs seek leave to file a Fourth Amended Complaint. (Dkts. 67 and 68). Defendant filed a "Preliminary Objection."

[11] Defendant also argues that this claim is barred by the statute of limitations. Mississippi law provides for a three year statute of limitations for actions accruing on or after July 1, 1989. Miss. Code § 15-1-49. See McMahon v. McMahon, 157 So.2d 494, 501 (Miss. 1963). The three year statute of limitations governs fraud claims. Fortenberry v. Foxworth Corp., 825 F. Supp. 1265 (S.D. Miss. 1993).

(Dkt. 73). Plaintiffs thereafter filed the "Declaration of David G. Finkelstein in Response to Defendant Wal-Mart Stores, Inc.'s Opposition to Plaintiff's Motion to File Fourth Amended Complaint." (Dkt. 74). Defendant subsequently filed a "first supplement" to its objections to Plaintiffs' motion to amend. (Dkt. 75).

Neither the Local Rules for the Northern District of California nor the Federal Rules of Civil Procedure provide for preliminary and supplemental responses to motions. However, for the purposes of this motion, Defendant's supplemental response will be considered.[12]

Rule 15(a) of the Federal Rules of Civil Procedure provides that after a responsive pleading has been served, "a party may amend [its] pleading only by leave of the court or by written consent of the adverse party; and leave shall be freely given when justice so requires." Although the rule is to be construed

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[12] Defendant also filed a "Motion for Leave to File Supplement to [its] Final Objection to Plaintiff's Motion for Leave to File Fourth Amended Complaint," apparently referring to its supplemental response. In the motion, Defendant seeks leave to file a supplement regarding the use of "partner" in the business community, which was arguably relevant to Plaintiffs' motion for leave to file a third amended complaint. However, inasmuch as that motion was denied, Defendant's motion for leave to file an additional supplement will be denied as moot.

liberally, "leave to amend is not to be granted automatically." Jackson v. Bank of Hawaii, 902 F.2d 1385, 1387 (9th Cir. 1990). "While Fed. R. Civ. P. 15(a) encourages leave to amend, district courts need not accommodate futile amendments." Newland v. Dalton, 81 F.3d 904, 907 (9th Cir. 1996)(citing Klamath-Lake Pharmaceutical Ass'n v. Klamath Medical Service Bureau, 701 F.2d 1276, 1293 (9th Cir. 1983), cert. denied, 464 U.S. 822 (1983)).

In determining whether to permit a party to amend a pleading, the Court should consider:

(1) whether the movant unduly delayed seeking leave to amend;

(2) whether there is any bad faith or dilatory motive on the part of the movant;

(3) whether there have been repeated failures to cure deficiencies by amendments previously allowed;

(4) whether the party opposing amendment would be unduly prejudiced by the amendment; and

(5) whether amendment would be futile.

Foman v. Davis, 371 U.S. 178, 182 (1962). See United States v. Pend Oreille Public Utility Dist. No.1, 926 F.2d 1502, 1511-12 (9th Cir. 1991)(leave to amend should have been granted in the absence of prejudice and bad faith and where amendment was not frivolous), cert. denied, 502 U.S. 956 (1992); DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 186-87 (9th Cir. 1987).

Plaintiffs seek leave to amend their complaint to add a claim for fraudulent concealment and misrepresentation as to each of the locations. Plaintiffs allege that Defendant has and had "a long-standard undisclosed policy" of "reserving the unilateral option of closing down Wal-Mart Store operations" to avoid the payment of percentage rentals projected by it to induce investors to participate in sale leaseback arrangements. Plaintiffs further allege that Defendant concealed this policy from them in the sale- leaseback transaction at issue.[13]

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[13] The Court previously denied Plaintiffs' motion to add claims for breach of fiduciary duty based on a joint venture relationship. "A joint venture is ‹an undertaking by two or more persons jointly to carry out a single business enterprise for profit.' . . . ‹Like partners, joint venturers are fiduciaries with a duty of disclosure and liability to account for profits.'" Weiner v. Fleischman, 54 Cal.3d 476, 482, 816 P.2d 892, 895 (1991)(in bank)(internal citations omitted). Furthermore:

> ". . . A joint venture exists where there is an ‹agreement between the parties under which they have a community of interest, that is, a joint interest, in a common business undertaking, an understanding as to the sharing of profits and losses, and a right of joint control.' ... An essential element of a partnership or a joint venture is the right of joint participation in the management and control of the business. ... Absent such right, the mere fact one party is to receive benefits in consideration of services rendered or for capital contribution does not, as a matter of law, make him a partner or joint venturer. ... An agreement by a landowner to share with another profits to be derived from the sale of

Interestingly, Plaintiffs do not allege that this undisclosed policy was employed as to the other nine properties purchased by them and leased to Defendant. Defendant contends that Plaintiffs unduly delayed in seeking leave to add this claim and that it is futile.

As noted above, under California (and common law generally), a promise or representation of future conduct is only actionable as fraud if it was made without the present intent to perform. O'Mary v. Mitsubishi Electronics America, Inc., 59 Cal.App.4th 563, 579, 69 Cal.Rptr.2d 389, 399 (Ct.App. 1998); Magpali v. Farmers Group, Inc., 48 Cal.App.4th 471, 55 Cal.Rptr.2d 225 (Ct.App. 1996). See id.

Plaintiffs do not allege that Defendant entered into the sale leaseback transaction without the intention of performing at the time it executed the Purchase Agreement and leases. Plaintiffs instead allege that Defendant mislead them about the income stream from the properties by not explicitly informing

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land does not, without more, create a partnership or joint venture relationship."

Kaljian v. Manezes, 36 Cal.App.4th 573, 585, 42 Cal. Rptr.2d 510, 517 (Ct.App. 1995)(internal citations omitted).

It is clear that the parties in this case never agreed to joint management or control, nor that they agreed to divide the profits and losses.

them that it retained the right to cease operations at one or all of the thirteen properties. Plaintiffs imply that Defendant owed them a fiduciary duty because it drafted the leases and the Purchase Agreement and specific terms could not be negotiated. That a seller insists on specific forms or terms does not transform it into a fiduciary; if the terms were unacceptable, Plaintiffs could have walked away. They chose not to. Plaintiffs have not alleged that Defendant entered the sale leaseback transaction or leases without the present intention to perform. Accordingly, Plaintiffs' amendment fails for futility. Plaintiffs' motion for leave to file a Fourth Amended Complaint will be denied.

The Court being fully advised,

IT IS ORDERED denying Plaintiffs' motion for leave to file a Fourth Amended Complaint. (Dkt.67).

IT IS FURTHER ORDERED granting Defendant's Motion for Summary Judgment. (Dkt. 46).

IT IS FURTHER ORDERED denying Plaintiffs' Motion to Compel. (Dkt. 52).

IT IS FURTHER ORDERED denying Defendant's Motion to Strike Plaintiffs' response to its Motion for Summary Judgment. (Dkt.

76-1).

IT IS FURTHER ORDERED denying as moot Defendant's Motion for Leave to File Supplement to its Objection to Plaintiffs' Motion for Leave to File their Third Amended Complaint.

IT IS FURTHER ORDERED denying as moot Defendant's Motion to Strike Motion Re Plaintiffs' Expert Witness.

IT IS FURTHER ORDERED denying Defendant's “Motion to Supplement Summary Judgment Brief with Single Case Citation.”

IT IS FURTHER ORDERED denying Defendant's “Second Motion to Supplement Summary Judgment Brief.”

IT IS FURTHER ORDERED entering judgment for Defendant and that Plaintiffs take nothing by this action.

DATED this _____ day of June, 1998.

Earl H. Carroll
United States District Judge